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# What Is a Trust? Definition, Account Types and Benefits

A well-designed trust can help save time, paperwork and other headaches when settling an estate.

By Tina Orem and Connor Emmert

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✔ Edited by Tina Orem

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## Nerdy takeaways

- Trusts aren't just for rich people. They can provide peace of mind by ensuring assets go to the right people.
- Trusts can avoid the public, court-supervised probate process for distributing your assets after death.
- You can create a trusts by working with an estate planning attorney or using estate planning software.

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A trust, sometimes called a trust fund or trust account, is a legal arrangement to

A trust, sometimes called a trust fund or trust account, is a legal arrangement to ensure a person's assets go to specific beneficiaries. The trust creator puts assets in the trust account and authorizes a trustee to administer those assets for the trust creator or beneficiaries.

Some trusts can reduce estate taxes[1].

Trusts have three main players:

1. **Grantor:** The person who creates the trust and puts assets in it.
2. **Beneficiary:** A person who eventually receives some or all of the assets in the trust.
3. **Trustee:** The organization or person who administers the trust.

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## Pros and cons of a trust

| Advantages | Drawbacks |
|---|---|
| **Control.** You can specify the terms of | **Cost.** Hiring an estate planning attorney to set up a trust and transfer your assets |

| | |
|---|---|
| the trust, which can help you protect assets after a divorce, for example, or control when kids receive their inheritance and how they spend it. | often costs over $1,000. Doing it yourself with an online will maker is more affordable, but can require more effort. |
| **Privacy.** Trust assets don't have to go through probate, which is part of the public record. A trust can help if you're disinheriting someone or have complex assets. | **Precision.** Trusts require specific language to be legally valid. If the terms aren't clear, someone could challenge the trustee later in court. |
| **Time.** Probate court can take several months. Trusts can avoid probate and get assets to your heirs faster. | **Time.** You'll need to spend time in advance dealing with paperwork and discussing your assets with heirs. Taxes may also be more time-consuming because some trusts have to file their own tax returns. |

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## Types of trusts

You can tailor a trust to your needs. There are various types of trusts to choose from, but all trusts fall under two main categories.

### 1. Revocable trusts

Revocable trusts, also called living trusts, are created during the grantor's lifetime and are generally used for:

- **Planning for incapacitation**. If you're diagnosed with a debilitating condition, you can get things in order before you're unable to do so. When that day comes, the successor trustee takes over managing the trust assets for you.
- **Avoiding probate.** Assets in a revocable trust can bypass probate, the time-consuming court process of settling an estate. Assets that pass through probate become part of the public record, so bypassing probate can be beneficial if you prefer to keep the details of the trust private.

With a revocable trust, the grantor can change the beneficiaries and assets as long as they're alive and physically and mentally able to do so. However, revocable trusts typically do not provide tax benefits or protection from creditors.

## 2. Irrevocable trusts

Irrevocable trusts are permanent once signed and funded. They're often used to minimize estate taxes because the assets in an irrevocable trust technically belong to the trust, not the grantor.

These trust accounts typically transfer assets after the grantor dies, and they hold lifetime gifts for the grantor's heirs or beneficiaries.

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## Specific types of trusts

- **Testamentary trust:** Created by the terms of your will; unlike other trusts, these trust accounts are only funded upon your death.
- **Grantor retained annuity trust (GRAT):** Allows the grantor to put certain assets into a temporary trust account and freeze its value, removing additional appreciation from the estate and giving it to heirs with minimal estate or gift tax liability.
- **Education trust:** Beneficiaries can only use the money in the trust account for educational expenses.
- **Spendthrift trust:** The trustee decides how the beneficiary is allowed to use the money.
- **Charitable trust:** An irrevocable trust that donates assets in the trust account to one or more charities.
- **Special needs trust:** Supports beneficiaries with functional needs without disqualifying them from government benefits such as Medicaid or Supplemental Security Income (SSI).
- **Qualified personal residence trust:** An irrevocable trust in which you transfer a house to your heirs but get to live in it for a specified period first.
- **Qualified terminable interest property (QTIP) trust:** When the first spouse dies, the assets in the trust account support the surviving spouse; when the surviving spouse dies, the remaining assets go solely to the first spouse's chosen beneficiaries.
- **Generation-skipping trusts:** A trust in which you transfer money to grandchildren or people at least 37.5 years younger than you.

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## How to set up a trust

You can consult an estate planning attorney to draft your trust documents or create a "do-it-yourself" trust using online estate planning software for a lower-cost option. Some companies also offer discounted estate planning services as part of their employee benefits packages.

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Here are the five general steps to set up a trust:

1. **Determine what kind of trust best fits your needs.** It's a good idea to consult with an estate planning attorney about your requirements.
2. **Create a trust document.** Your attorney will help you do this. Or, if you're setting up the trust through an online service, most companies will provide some guidance to help you through the process.
3. **Get it signed and notarized.** Depending on your state laws, you may need multiple signatures from the grantor(s) and trustee(s), and you might also need witnesses during the process.
4. **Open a trust account.** Trust accounts can hold many different types of assets, including cash, stocks, bonds, mutual funds, real estate and other property.
5. **Transfer assets into the trust account.** If the trust is part of an estate plan, you can designate the trust as one of your beneficiaries. That way, your assets move to the trust account when you die.

trust account when you die.

Trusts can be complex and intricate, so if you're unsure about the best choices for you and your family, consult with a legal or financial professional before creating one.

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## What is a trust fund?

A trust fund is the actual account or legal entity that holds the trust's assets; a trust is the legal agreement that creates the fund[2]. The terms are often used interchangeably.

The term "trust fund" is commonly associated with trusts created by wealthy parents for their children, inspiring the term "trust fund baby" in popular culture. Though trust funds are an estate planning tool commonly used to preserve wealth for future generations, they're not solely for large inheritances or people with large estates. Trusts can help everyday people avoid the probate process and ensure their assets are distributed as they wish after they die.

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## How does a trust fund work?

Trust funds can hold assets including bank accounts, real estate, tangible personal property, stocks and bonds, or digital assets. Assets such as bank accounts and real estate can be titled to the trust, but smaller items, including family heirlooms, may require an assignment of property form.

## What is a trust account?

A trust account is another word for a trust. It can refer to either the legal trust arrangement or to the bank account itself that holds the funds. Generally, a trustee manages the funds in a trust account for its grantor and ensures that the funds end up with the designated beneficiary.

## Taxes and trusts

Trust tax laws can be complicated, so it's helpful to consult with a tax professional if you're using a trust to take advantage of tax benefits. Here are a few things to keep in mind:

- **Estate taxes.** If you have a large estate, your assets may be subject to federal estate tax when you die.The federal estate tax ranges from rates of 18% to 40% and

generally only applies to assets over $12.92 million in 2023 or $13.61 million in 2024. Some states have their own estate taxes, so there could be two estate tax bills to pay. Irrevocable trusts can lower your estate taxes by removing the assets from your estate[3].

- **Inheritance taxes.** There's no federal inheritance tax, but some states have one — and Maryland has both estate and inheritance taxes. The people who inherit the money pay the tax, and rates can vary depending on the relationship with the deceased (spouse vs. child, for example).
- **Capital gains and income taxes.** The assets in a trust account might generate income, which could trigger income taxes or capital gains taxes. Who pays that tax depends on who legally owns the assets, and charitable donations may be exempt.

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